

ADVANTAGE FOR CREDITORS IN SOUTH AFRICAN INSOLVENCY LAW – A COMPARATIVE INVESTIGATION

by

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ABSTRACT

The main aim of the sequestration process, in terms of the Insolvency Act, is to provide for a collective debt collecting process that will ensure an orderly and fair distribution of the debtor's assets in circumstances where these assets are insufficient to satisfy all the creditor's claims. This is to make sure that the interests of the group of creditors are protected and that one creditor is not favoured before another. The insolvent estate of a debtor may be sequestrated by himself voluntarily or one or more of his creditors may apply for the compulsory sequestration of his estate

Under present South African law, the only way in which an insolvent debtor can obtain a discharge of his debts and make a fresh start is by the sequestration of his estate. Providing the debtor with debt relief is not the main aim of the Insolvency Act, but debt relief is an indirect consequence as the debtor receives a discharge of all pre-sequestration debt after rehabilitation. However, in order to obtain this discharge the sequestration of the insolvent debtor's estate must be to the advantage of his or her creditors. In establishing this advantage for creditors in order to sequester one's estate, the question is whether the balance between all the parties involved is achieved as more and more weight is being placed on this requirement.

This benefit for creditors requirement has also led to abuse of the insolvency law through the development of the so called "friendly" sequestration process where the sequestering creditor and the debtor collude together in order to bypass the stringent requirements of a voluntary surrender application. Many other jurisdictions have witnessed large scale reform of their insolvency law systems in order to address the problem of insolvencies. Notwithstanding the worldwide trend to accommodate overburdened debtors seeking debt relief, the South African insolvency system has remained largely creditor orientated.

The research will discuss the current state of affairs with regard to the advantage for creditors requirement in South Africa and its impact on insolvency law.

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CHAPTER 1

INTRODUCTION

“The modern banking system manufactures money out of nothing. The process is perhaps the most astounding piece of sleight-of-hand that was ever invented. Banking was conceived in inequity and born in sin. But if you want to continue to be slaves of the bankers and pay the cost of your own slavery, then let the bankers continue to create money and control credit.”¹

Any process which follows insolvency must of necessity entail a delicate balancing act between the interests of the various stakeholders: being the unpaid creditors, the insolvent debtor and the general public.² Under present South African law, the only way in which an insolvent debtor can obtain a discharge of his debts and make a fresh start is by the sequestration of his estate. However, in order to obtain this discharge the sequestration of the insolvent debtor’s estate must be to the advantage of his or her creditors.³ In establishing this advantage for creditors in order to sequester one’s estate, the question is whether the balance between all the parties involved is achieved as more and more weight is being placed on this requirement. The requirement of advantage for creditors has been described as ‘a recurrent motif or dominant thread’ of the Insolvency Act.⁴

During the last three decades South Africa has witnessed not only a sharp increase in consumer debt, but also a strong increase in the granting of credit to individuals.⁵ Many other jurisdictions have witnessed large scale reform of their insolvency law systems in order to address the problem of insolvencies. It is widely accepted that the American insolvency system leads the way in this respect, because it accepts debt relief by means of a procedural discharge as its theoretical basis, and in so

¹ Josiah Charles Stamp see http://www.allgreatquotes.com/money_quotes.shtml accessed on 1 October 2013.

² Loubser “Ensuring advantage to everyone in a modern South African insolvency law” 1997 *SA Merc LJ* 326.

³ 24 of 1936 (hereinafter referred to as “the Act”). See sections 6(1), 10(c) and 12(1)(c).

⁴ Smith “The recurrent motif of the Insolvency Act – Advantage of creditors” 1985 *Modern business law* 27.

⁵ Roestoff and Renke “Solving the problem of overspending by individuals: International guidelines” 2003 *Obiter* 1.

doing enables the debtor to make a fresh start.⁶ The English system can be described as pro-debtor due to various provisions in the Act. At the heart of the English insolvency system are inter alia its principal aims of the release from debt and the affiliated fresh start approach.⁷ The tale of the South African attempt to adopt new legislation started in the late 1980's and has not yet managed to culminate in the promulgation of modern and effective insolvency legislation.⁸ Providing the debtor with debt relief is not the main aim of the Insolvency Act,⁹ but debt relief is an indirect consequence as the debtor receives a discharge of all pre-sequestration debt after rehabilitation.¹⁰ However, the South African law does not provide for a procedure for the release from debt outside of the scope of this Act.

South African law has adopted new legislation over the past decade in an attempt to provide several options of debt relief to consumers. The National Credit Act¹¹ makes provision for debt counselling of over indebted debtors and the Magistrates' Courts Act¹² makes provision for administration orders to be granted to debtors with a maximum debt of R50,000.00. The biggest criticism leveled at these attempts to offer debt relief to overburdened consumers by the legislator, is that neither of them offers a discharge of any part of the debt and the full outstanding amount must be repaid before the order is lifted. These options do not form part of the main aim of this dissertation and will not be discussed further.

The aim of this dissertation is to discuss the current state of affairs with regard to the advantage for creditors requirement in South Africa and its impact on insolvency law. This dissertation is divided into five chapters. This chapter contains the introduction to the research. Chapter 2 will explain in detail the requirements needed to comply with in order to apply for voluntary and compulsory sequestration. The chapter further briefly discusses the friendly sequestration procedure. Chapter 3 contains the essence of the dissertation as it discusses the benefit for creditors requirement in

⁶ Roestoff and Renke 2003 *Obiter* 2.

⁷ Roestoff and Renke 2003 *Obiter* 3.

⁸ Calitz "Developments in the United States' consumer bankruptcy law: a South African perspective" 2007 *Obiter* 397.

⁹ 24 of 1936.

¹⁰ Section 129(1)(b). See also *Ex parte Ford* 2009 3 SA 376 (WCC) and *R v Meer* 1957 3 SA 614 (N) where the courts held that the Insolvency Act was for the benefit of creditors.

¹¹ 34 of 2005.

¹² 32 of 1944.

great detail and the impact it has on the insolvency system. Cases are referred to in order to showcase the court's strict compliance with this requirement before considering granting an application for sequestration. I discuss the abuse of the sequestration process and also look at possible law reform in South Africa as proposed by the South African Law Reform Commission. Chapter 4 concerns the development of the insolvency systems in England and America over the past few decades. The chapter also looks at the possibility of using some of the developments in those jurisdictions as a point of departure in modernizing the South African dispensation. Chapter 5 contains the conclusion to the research.

CHAPTER 2

SEQUESTRATION IN TERMS OF THE INSOLVENCY ACT

2.1 Introduction

The purpose of this chapter is to discuss the different forms of sequestration being voluntary, compulsory and the so called ‘friendly sequestration’ and the requirements which need to be complied with in each of them. The requirements to be declared insolvent are discussed as well as the main aims and object of the Insolvency Act.¹³

From the discussion below, it will be clear that the benefit for creditors requirement poses the biggest stumbling block in the way of debtors looking to make use of insolvency as a form of debt relief. The requirement of advantage for creditors is briefly discussed here where after an in depth discussion of this topic is the focus point in chapter three.

2.2 Main aim of sequestration

The main aim of the sequestration process in terms of the Act is to provide for a collective debt collecting process that will ensure an orderly and fair distribution of the debtor’s assets in circumstances where these assets are insufficient to satisfy all the creditor’s claims.¹⁴ The Insolvency Act provides for two forms of sequestration, namely voluntary surrender¹⁵ by the debtor himself and compulsory sequestration¹⁶ of the debtor’s estate by his or her creditors. Both voluntary surrender and compulsory sequestration are instituted by means of the application procedure in the High Court.

In *Ex parte Ford*¹⁷ the court held that the object of the Insolvency Act is to benefit creditors and not to provide debt relief to debtors. In *Mayet v Pillay*¹⁸ the court

¹³ 24 of 1936. Hereinafter referred to as “the Act”.

¹⁴ Bertelsmann et al *Mars : The law of insolvency in South Africa* (hereinafter Mars).

¹⁵ Section 3.

¹⁶ Section 9.

¹⁷ 2009 3 SA 376 (WCC).

remarked that the Insolvency Act was passed for the benefit of creditors and not for the relief of harassed debtors. Therefore, according to case law, the main aim of the Insolvency Act is to benefit creditors. However, it is an indirect consequence of the Act that debt relief is provided as the debtor receives a complete discharge of pre-sequestration debts after rehabilitation.¹⁹

The Insolvency Act does not define the term “insolvency”. However it does define the terms “insolvent”²⁰ (as a noun) and “insolvent estate”²¹ in section 2 of the Act. According to the decision in *Venter v Volskas Ltd*²² the test for “insolvency” is whether the debtor’s liabilities, fairly estimated, exceed his assets, fairly valued. Even though the terms “actual insolvency”²³ and “commercial insolvency”²⁴ are not expressly defined in the Act, the distinction is still recognised by the Act and approved by our courts.²⁵

Once a sequestration order is made a *concursum creditorum* comes into being.²⁶ The concept of the *concursum creditorum* means that the rights of the creditors as a group are preferred to the rights of the individual creditor.²⁷ In *Walker v Syfret*²⁸ the court stated that once the *concursum creditorum* has been established, no transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body of creditors.

According to section 2 of the Insolvency Act a ‘debtor’ (in connection with the sequestration of the debtor’s estate) means a person or partnership or the estate of a person or partnership which is a debtor in the usual sense of the word, except a body corporate or a company or other association of persons which may be placed

¹⁸ 1955 2 SA 309 (N). For more recent case law see also *Ex parte Shmukler-Tshiko* 2013 JOL 29999 (GSJ) and *Ex parte Arntzen* 2013 1 SA 49 (KZP) where this view was again confirmed.

¹⁹ Section 129(1)(b).

²⁰ In terms of section 2 ‘insolvent’ when used as a noun, means a debtor whose estate is under sequestration and includes such a debtor before the sequestration of his estate according to the context.

²¹ Section 2 defines ‘insolvent estate’ as meaning an estate under sequestration.

²² 1973 3 SA 175 (T) 179.

²³ Actual insolvency is found where a debtor’s liabilities exceed his assets.

²⁴ Commercial insolvency refers to the situation where a debtor is unable to pay his debts as they become due, as a result of a cash flow or other problem, but his assets still exceed his liabilities.

²⁵ Mars 2.

²⁶ *Ibid.*

²⁷ *Ibid.*

²⁸ 1911 AD 141.

in liquidation under the law relating to companies.²⁹ Once a sequestration order is given by the High Court, the debtor loses control of his or her estate and such estate will vest in the Master of the High Court, followed by such vesting in the trustee after his or her appointment by the Master.³⁰

2.3 Voluntary surrender

In terms of section 3(1), the debtor, his duly authorised representative, the *curator bonis* of a person who is incapable of handling his own estate or the executor of a deceased estate may apply for voluntary surrender. Section 17(4)(a) of the Matrimonial Property Act³¹ provides that where the parties are married in community of property, both spouses must apply for the voluntary surrender because they are regarded in law as equal managers of their joint estate.

2.3.1 Preliminary formalities

There are three formalities that must be complied with in terms of section 4 of the Act before a debtor can apply for voluntary surrender. Firstly the debtor must publish a notice of surrender, in the Government Gazette, and a local newspaper.³² Secondly, the debtor must send a copy of the notice to, creditors,³³ the South African Revenue Service,³⁴ every trade union representing his employees,³⁵ and the employees themselves.³⁶ Lastly, the debtor must prepare a statement of affairs.³⁷

2.3.1.1 Notice of intention to surrender

In terms of section 4(1), the applicant must no more than 30 days and no less than 14 days before the date of application, cause to be published in the Government Gazette and any newspaper circulating in the magisterial district where he resides,

²⁹ Section 2.

³⁰ Section 20(1)(a).

³¹ 88 of 1984.

³² Section 4(1).

³³ Section 4(2)(a).

³⁴ Section 4(2)(b)(iii).

³⁵ Section 4(2)(b)(i).

³⁶ Section 4(2)(b)(ii).

³⁷ Section 4(3).

or where he is a trader, in the district where his principle place of business is situated, a notice of his intention to surrender his estate. The date of the advertisement is excluded and the date of the application is included.³⁸

The purpose of the notice is to ensure that creditors know of the intention to apply should they wish to oppose the application.³⁹ The formalities must be strictly complied with. However, the court may condone a mistake in terms of section 157(1), where the mistake constitutes a “formal defect”.⁴⁰ Where the mistake prejudices the creditors and cannot be corrected by an order of court, it may not be condoned.⁴¹ The test that is typically applied in this instance is whether the relevant provisions are peremptory or merely directory.⁴²

The publication further also has the effect that all sales in execution are stayed⁴³ and the Master may appoint a *curator bonis* to temporarily control the estate.⁴⁴ Publication of the application, as required by the Act, also has the effect that the debtor commits an act of insolvency if he fails to apply for the acceptance of the voluntary surrender of his estate on the date advertised or fails to lodge a statement of affairs or lodges an incomplete or incorrect statement.⁴⁵

2.3.1.2 A copy of the notice to the required parties

The debtor must then, within seven days from the date of publication of the voluntary surrender, send a copy of the notice to all known addresses of possible creditors.⁴⁶

The debtor must further, within the seven-day period, furnish a copy of the notice by

³⁸ Kunst *et al Meskin: Insolvency law and its operation in winding-up* (1990) 3-6. (hereinafter Meskin).

³⁹ Nagel *Commercial Law* (2011) 408.

⁴⁰ Section 157(1).

⁴¹ *Ibid.*

⁴² In *Ex Parte Oosthuysen* 1995 2 SA 694 (T) the court refused to hear an application for voluntary surrender where the notice of surrender was published 39 days before the date of application. However, in *Ex Parte Harmse* [2004] 1 All SA 626 (N) the full bench criticized the judgment in the *Oosthuysen* case. Although the court in *Harmse* agreed with the *Oosthuysen* case that the court should decide whether the formalities are directory or peremptory, the full bench concluded that the court in that case followed a narrow interpretation and should have included section 6(2) as well. They further stated that the extent to which the debtor has complied with the Act is also important. Needless to say, they did not follow the *Oosthuysen* ruling and condoned the application in terms of section 157(1).

⁴³ Section 5(1).

⁴⁴ Section 5(2).

⁴⁵ Section 8(f).

⁴⁶ Section 4(2)(a).

post to every registered trade union that to the applicant's knowledge represents any of the debtor's employees⁴⁷ and also to the South African Revenue Service.⁴⁸ The debtor must also furnish a copy to the employees⁴⁹ themselves by affixing a copy of the notice to any notice board to which the employees have access inside the debtor's premises. If there is no access available to the employees, then a copy of the notice should be affixed to the front gate of the premises, failing which to the front door of the debtor's business premises immediately prior to the surrender.

2.3.1.3 The debtor must prepare a statement of affairs

The debtor must lodge a statement of his affairs, in duplicate, at the Master's office.⁵⁰ The said statement must comply with Form B of the first Schedule of the Act and be verified by an affidavit. Two copies must lie for inspection for fourteen days⁵¹ at the Master's office or in a Magistrate's court, if the debtor resides or carries on business in an area where there is no Master's office for that district.⁵² The statement shall lie open for inspection during office hours, by any of the creditors, for a period of fourteen days where after the Master will issue the certificate stating whether the statement of affairs has duly lain for inspection as advertised.⁵³

2.3.2 The applicant's burden of proof

The debtor's burden of proof is on a balance of probabilities and he must in terms of section 6 show that firstly, the prescribed formalities as set out in section 4 have been complied with.⁵⁴

Secondly, the applicant must actually be insolvent. Where the statement of affairs shows a credit balance, the applicant will have to prove that he is nonetheless

⁴⁷ Section 4(2)(b)(i).

⁴⁸ Section 4(2)(b)(iii).

⁴⁹ Section 4(2)(b)(ii).

⁵⁰ Section 4(3).

⁵¹ Section 4(6).

⁵² Section 4(5).

⁵³ Section 4(6).

⁵⁴ Section 6(1).

actually insolvent.⁵⁵ The test used to determine actual insolvency is whether the debtor's liabilities, fairly valued, exceed his assets, fairly valued.⁵⁶ Facts must be given to show that the debtor has by misfortune and without fraud or dishonesty on his part become insolvent, since the court will not come to the assistance of a debtor whose conduct is shown to have been dishonest or reprehensible.⁵⁷

Thirdly, there must be sufficient assets in the free residue of his estate to cover all the sequestration costs. The debtor must show that he or she owns realizable property of a sufficient value to defray costs of the sequestration, which is payable from the free residue of the estate.⁵⁸ These are the assets in the estate, which are not subject to any right of preference by reason of a special mortgage, legal hypothec, pledge or right of retention.⁵⁹ In Gauteng and the Cape, the value of the free residue must be at least R20 000 to pay for all the costs of the sequestration.⁶⁰ This amount is, however, adjusted from time to time.

Finally the debtor must prove that sequestration is to the advantage of the creditors.⁶¹ The sequestration must be to the advantage of the group of creditors as a whole and they must at least receive a dividend.⁶² It was held in *Ex parte Ogunlaja*⁶³ that voluntary surrender must provide for a minimum of 20 cents in the rand in order to be to the advantage of creditors. There will be no advantage for creditors if no dividend or only a negligible dividend is payable after the sequestration costs are paid.⁶⁴ The debtor is bound fully, to disclose his property and his financial position, and accordingly he must prove on a balance of probabilities that in fact there will be the requisite advantage to creditors as a whole.⁶⁵

⁵⁵ *Ibid.*

⁵⁶ *Venter v Volskas Ltd* 1973 3 SA 175 (T) 179.

⁵⁷ Legal Education And Development (LEAD) *Insolvency Law Practice Manual 2012* 17.

⁵⁸ Section 6(1)

⁵⁹ Section 2.

⁶⁰ Legal Education And Development (LEAD) *Insolvency Law Practice Manual 2012* 18.

⁶¹ Section 6(1). This requirement will be dealt with extensively in chapter three below.

⁶² Nagel 410.

⁶³ 2011 JOL 27029 (GNP).

⁶⁴ *Trust Wholesalers and Woolens (Pty) Ltd v Mackan* 1954 2 SA 109 (N).

⁶⁵ Meskin 3-4.

Where all four aspects are proven, the court still has the discretion of whether to accept the surrender of the estate or not.⁶⁶

2.4 Compulsory sequestration

According to section 9(1), a creditor or his agent can lodge an application to court for the sequestration of the estate of the debtor. However, the creditor must have a liquidated claim of at least R100 or if there are two creditors, then they must in aggregate have a liquidated claim of at least R200 against the debtor who has committed an act of insolvency or is insolvent.⁶⁷ Where an application is made for compulsory sequestration, the court will first make a provisional sequestration order before placing the estate under final sequestration.⁶⁸

The applicant needs to prove the following in an application for compulsory sequestration before a final sequestration order can be made. Firstly, that all the preliminary formalities have been complied with. These being, security for costs⁶⁹ and furnishing interested parties with a copy of the application.⁷⁰ Secondly, that he does in fact have a liquidated claim as stated in section 9(1).⁷¹ Thirdly, that the debtor is actually insolvent, or that the debtor has committed an act of insolvency.⁷² Lastly that there is reason to believe that it would be advantageous to creditors if the estate of the debtor were sequestrated.⁷³

2.4.1 Preliminary formalities

2.4.1.1 Security for costs

The sequestrating creditor must give sufficient security to the Master to defray all of the sequestration costs until a trustee is appointed, or if no trustee is appointed, all

⁶⁶ Section 6(1) and (2).

⁶⁷ Section 9(1).

⁶⁸ Sections 10 and 12.

⁶⁹ Section 9(3)(b).

⁷⁰ Section 9(4)(A).

⁷¹ Section 12(1)(a).

⁷² Section 12(1)(b).

⁷³ Section 12(1)(c).

fees and charges necessary for the discharge of the estate from the sequestration.⁷⁴ The applicant must obtain a certificate from the Master, stating that sufficient security has been given, no more than ten days before the application for sequestration.⁷⁵

2.4.1.2 Furnishing interested parties with a copy of the application

In the past, the Insolvency Act did not require the applicant creditor to notify the debtor of the impending application to sequester the debtor's estate or to furnish him with a copy of the application.⁷⁶ However, section 9(4A)(a)(iv) now specifically provides that a copy of the application be furnished to the debtor. The court may however dispense with this requirement where it is satisfied that it would be in the interest of the debtor or the creditors to do so.⁷⁷

Section 9(4A)(a)(i)-(iii) further provides that when an application is presented to the court, the applicant is required to furnish a copy to every registered trade union that, as far as he can reasonably ascertain, represents any of the debtor's employees, the employees themselves and to the South African Revenue Service.

2.4.2 Creditor's claim

The creditor must have a liquidated claim of at least R100 or if there are two creditors, then they must in aggregate have a liquidated claim of at least R200 against the debtor who has committed an act of insolvency or is insolvent.⁷⁸ This claim must be a liquidated claim.⁷⁹ A liquidated claim which has accrued but which is not yet due on the date of hearing of the petition, shall be reckoned as a liquidated claim.⁸⁰

⁷⁴ Section 9(3)(b).

⁷⁵ *Ibid.*

⁷⁶ Meskin 2-37

⁷⁷ Meskin 2-38.

⁷⁸ Section 9(1).

⁷⁹ A liquidated claim, is a claim for an amount of money which is certain and determined by an order of court, agreement or otherwise.

⁸⁰ Section 9(2).

2.4.3 Actual insolvency or acts of insolvency

The applicant creditor can base his claim on actual insolvency of the debtor or an act of insolvency committed by the debtor in terms of section 8.⁸¹ A practical problem often exists where a creditor has to prove that the debtor is actually insolvent. Actual insolvency, in this context, denotes that the debtor's liabilities actually exceed the value of his assets.⁸² The creditor will often have to rely on indirect evidence, such as dishonouring of a cheque or the debtor's request for an extension of time to pay.⁸³ Such evidence will not necessarily be conclusive of an actual state of insolvency, but such an inference may be drawn by the courts, notwithstanding that the precise amount of the deficiency is uncertain.⁸⁴

The alternative to relying on the actual insolvency of the debtor, is for the creditor to base his claim on an act of insolvency committed by the debtor as listed in section 8.⁸⁵ Meskin submits that the reason for the provisions in section 8 is the legislature's recognition of the fact that in practice a creditor seldom has sufficient evidence available to him to prove that his debtor is actually insolvent.⁸⁶ Settlement negotiations between a debtor and creditor may be used to prove such a debtor's actual insolvency or an act of insolvency during court proceedings even if such negotiations were conducted without prejudice.⁸⁷

2.4.4 Advantage for creditors

The court may not grant a sequestration order unless it is established that "there is reason to believe that it will be to the advantage of creditors."⁸⁸ Actual advantage to creditors need not be established.⁸⁹ The burden of proof rests on the sequestrating creditor. This onus is less stringent in the case of compulsory sequestration than for

⁸¹ Meskin 2-6.

⁸² Meskin 2-17.

⁸³ *Ibid.*

⁸⁴ Meskin 2-18.

⁸⁵ Meskin 2-6.

⁸⁶ *Ibid.*

⁸⁷ Nagel 413, See also *ABSA Bank Ltd v Chopdat* 2000 2 SA 1088 (W), *Lynn & Main Inc v Naidoo* 2006 1 SA 59 (N).

⁸⁸ Meskin 2-18.

⁸⁹ Meskin 2-18(1).

voluntary surrender.⁹⁰ This is so because of the fact that the sequestrating creditor does not have the same personal knowledge of the debtor's financial affairs as the debtor himself would have in the case of voluntary surrender.

There is reason to believe that sequestration will be to the advantage of creditors if there are facts proved which indicate that “there is a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to creditors.”⁹¹

The advantage must be in favour of the group of creditors as a whole.⁹² This requirement is fulfilled where it is established that there is reason to believe that there will be advantage to a “substantial proportion” or the “majority” of the creditors reckoned by value.⁹³ Meskin submits further that there is some difference of judicial opinion on the matter and that the correct position is that it does not follow necessarily from the commission of any act of insolvency that there is reason for the relevant belief.⁹⁴

The court is not bound by the wishes of the creditor as to the reason that the sequestration will be to his benefit, but the courts accept that the creditor generally knows what is in his own commercial interests.⁹⁵

2.4.5 Provisional sequestration

The court grants a provisional sequestration order before it may grant a final sequestration order. The provisional sequestration order is granted if the court is satisfied that *prima facie* the abovementioned requirements have been met.⁹⁶ Once the court grants a provisional sequestration order, it must simultaneously grant a *rule nisi* calling upon the debtor to show cause why his estate should not be sequestrated

⁹⁰ Wording of section 6(1) and sections 10(c) and 12(1)(c).

⁹¹ *London Estates (Pty) Ltd v Nair* 1957 3 SA 591 (N); *Lynn & Main Inc v Naidoo and Another* 2006 1 SA 59 (N).

⁹² Meskin 2-19.

⁹³ *Ibid.* See also *Fesi and Another v ABSA Bank Ltd* 2000 1 SA 499 (C) 505–506.

⁹⁴ Meskin 2-20.

⁹⁵ Meskin 2-21.

⁹⁶ Section 10.

finally.⁹⁷ An original copy of the provisional sequestration order must be served on the debtor by the sheriff. The registrar must send one original to the Master, sheriff of every district in which the debtor resides or owns property, every Registrar of Deeds, every office having charge of a register of ships kept at a port of registry within the Republic and every sheriff who holds under attachment any of the debtor's property.⁹⁸

2.4.6 Final sequestration

If the abovementioned requirements have been met pursuant to the *rule nisi*, the court will grant a final sequestration order.⁹⁹ The court has the discretion to allow further proof or not.¹⁰⁰ According to section 150, the debtor may lodge an appeal against a final sequestration order. A final order can be rescinded in terms of section 149(2) where new evidence is brought before the court, which proves that the order should never have been granted in the first place. The debtor is also informed of the final order in the same manner as in provisional orders. Thereafter he, and his solvent spouse, must lodge a statement of affairs with the Master in duplicate within seven days.¹⁰¹

2.5 Friendly sequestrations

Friendly sequestrations are not specifically mentioned in the Insolvency Act and have developed as result of a family member or close friend of the insolvent debtor applying for the compulsory sequestration of his estate in order to obtain debt relief. The reason for doing this is because of the strict requirements which must be complied with in order for a voluntary surrender to succeed, especially with regard to the advantage for creditors requirement.¹⁰² These so called friendly sequestrations are usually based on acts of insolvency as listed in section 8.

⁹⁷ Section 11(1).

⁹⁸ Section 17.

⁹⁹ Section 12(1).

¹⁰⁰ *Ganes v Telecom Namibia Ltd* 2004 3 SA 615 (SCA).

¹⁰¹ Section 16.

¹⁰² Compare the wording of section 6(1) to that of sections 10(c) and 12(1)(c).

Where such a friendly or family relationship exists between the debtor and the creditor, the court has a duty to scrutinise the application with great care to ensure that there is an advantage for creditors and prevent any possible prejudice to them.¹⁰³ However, the mere fact that such a close relationship does exist between debtor and creditor should not prevent the granting of a sequestration order if all the requirements for compulsory sequestration are met.¹⁰⁴ However, such a friendly sequestration should fail if the main objective is to benefit only the debtor and not his creditors.¹⁰⁵

2.6 Conclusion

The main aim of the sequestration process, in terms of the Insolvency Act, is to provide for a collective debt collecting process that will ensure an orderly and fair distribution of the debtor's assets in circumstances where these assets are insufficient to satisfy all the creditor's claims.¹⁰⁶ This is to make sure that the interests of the group of creditors are protected and that one creditor is not favoured before another.

The insolvent estate of a debtor may be sequestrated by himself voluntarily or one or more of his creditors may apply for the compulsory sequestration of his estate.¹⁰⁷ The Insolvency Act has many requirements which must be established before the court will accept an application for sequestration. An important requirement that must be met, and the focus point of chapter three of this dissertation, is the requirement of advantage for creditors. This requirement is more stringent in the case of voluntary surrenders than with compulsory sequestrations, placing a rather large stumbling block in the way of many debtors wanting to use voluntary surrender as a form of debt relief. Due to this advantage for creditors requirement, one can conclude that the Insolvency Act is very much creditor orientated and only offers debt relief as a consequence of the discharge of all pre-sequestration debts after rehabilitation.

¹⁰³ See *Klemrock (Pty) Ltd v De Klerk* 1973 3 SA 925 (W); *Epstein v Epstein* 1987 4 SA 606 (C) and *Ex parte Shmukler-Tshiko* 2013 JOL 29999 (GSJ).

¹⁰⁴ *Jhatam v Jhatam* 1958 4 SA 36 (N).

¹⁰⁵ *Yenson v Garlick* 1926 WLD 53.

¹⁰⁶ See par 2.2 above.

¹⁰⁷ See par 2.3 and 2.4 above.

CHAPTER 3

ADVANTAGE FOR CREDITORS

3.1 Introduction

In this chapter I will critically evaluate the requirement of benefit for creditors in the Insolvency Act. This is one of the requirements which must be met in order for a court to declare a debtor insolvent.¹⁰⁸ I will discuss the various degrees of the benefit when dealing with voluntary surrender of one's personal estate as opposed to compulsory sequestration applications brought by the creditors against the debtor.

It is as a result of this requirement that the so called friendly sequestration process developed and the courts must now scrutinize these sequestrations very closely to ensure that there is advantage for creditors and that the sequestration process is not abused by debtors.¹⁰⁹

The advantage for creditors requirement has been fiercely debated between academics for decades with many in favour of its retention in our law and countless others submitting that it should be removed completely.¹¹⁰ I also explore the options of proposed law reform which have been envisaged since the late 1980's.

3.2 Meaning of advantage

The phrase "advantage for creditors" is not defined in the Insolvency Act. However, it is submitted that according to case law the advantage for creditors requirement entails a reasonable prospect of some pecuniary benefit to the general body of creditors.¹¹¹

¹⁰⁸ Sections 6(1), 10(c) and 12(1)(c). See chapter 2 above.

¹⁰⁹ *Ex parte Shmukler-Tshiko* 2013 JOL 29999 (GSJ).

¹¹⁰ Roestoff and Coetzee "A critical evaluation of consumer debt relief in South Africa – Lessons from the United States of America, England and Wales and suggestions for the way forward" 2012 *SA Merc LJ* 53 and Rochelle "Lowering the penalties for failure: using the insolvency law as a tool for spurring economic growth; the American experience, and possible uses for South Africa" 1996 *TSAR* 315.

¹¹¹ See *Lynn & Main Inc v Naidoo* 2006 1 SA 59 (N); *Ex parte Bouwer & Similar Applications* 2009 6 SA 382 (GNP). This pecuniary benefit is further examined in par 3.4 below.

The primary objective of the Insolvency Act is not to grant debt relief to a debtor.¹¹² However, the primary objective is that the sequestration of the debtor's estate should be to the advantage of creditors, not one creditor or some creditors, but the general body of creditors as a whole.¹¹³ When a debtor's estate is sequestrated, there must be a reason to believe that the sequestration of his estate will be to the advantage of his creditors.¹¹⁴

3.3 Burden of proof

The onus of proving an advantage for creditors in the case of a voluntary surrender lies with the insolvent debtor himself and in the case of compulsory sequestration the onus is on the sequestrating creditor. The sequestrating creditor must establish this reasonable belief *prima facie* at the stage when a provisional order is sought and on a balance of probabilities when a final order is sought.¹¹⁵

The requirement of advantage for creditors is more stringent in the case of voluntary surrender than for compulsory surrender.¹¹⁶ Voluntary surrender requires actual proof of advantage for creditors, whereas compulsory sequestration requires only a reasonable prospect that it will be to the advantage of the creditors if the debtor's estate were sequestrated. The reason for this is because the debtor in a voluntary surrender has a more in depth knowledge of his personal financial circumstances than the sequestrating creditor will have in the case of a compulsory sequestration.¹¹⁷ In *Ex parte Shmukler-Tshiko*¹¹⁸ the court held that applicants in voluntary applications must demonstrate a reasonable expectation that a sequestration will exceed the likely proceeds of ordinary execution. Satchwell J said at par 60 that "Unless he [the debtor] does that, the laborious and substantially more expensive remedy of sequestration can hardly be thought to be advantageous."

¹¹² Bertelsmann et al *Mars : The law of insolvency in South Africa* 3 (hereinafter Mars).

¹¹³ *Ibid.*

¹¹⁴ Sections 6(1), 10(c) and 12(1)(c).

¹¹⁵ Kunst et al *Meskin: Insolvency law and its operation in winding-up* (1990) 2-20. (hereinafter Meskin).

¹¹⁶ Compare the wording of Sections 6(1) to 10(c) and 12(1)(c). See also *Ex parte Arntzen* 2013 1 SA 49 (KZP).

¹¹⁷ *Amod v Khan* 1947 2 SA 432 (N).

¹¹⁸ 2013 JOL 29999 (GSJ).

3.4 Reasonable pecuniary benefit

The South African Law Reform Commission referred to an investigation conducted in the Master's office of the High Court in Pretoria wherefrom it appeared that in only 28,6% of sequestrations, creditors received any dividend at all, while in 40,6% of the cases they examined, creditors actually had to make a contribution.¹¹⁹

In essence it would seem that the advantage for creditors requirement is that there must be enough assets in the estate to cover all the costs of the sequestration and yield a not negligible dividend to creditors.¹²⁰

In *London Estates (Pty) Ltd v Nair*¹²¹ the court submitted that sequestration will be to the advantage of the creditors only when it results in some payment in respect of the claims of the creditors as a body, for example a not negligible dividend. The Act does not prescribe the amount of the dividend nor is it prescribed in the Government Gazettes.

In *ABSA Bank Ltd v De Klerk*¹²² the court regarded prospective dividends of 5 and 6 cents in the Rand as "not negligible" and not so small as to produce no advantage to creditors in the circumstances of the case. However, the court ruled in *Nieuwenhuizen v Nedcor Bank Ltd*¹²³ that this not negligible dividend must amount to a minimum of ten cents in the Rand.

Then again the court held in *Esterhuizen v Swanepoel*¹²⁴ that in the circumstances where the debtor had no assets of any substance, where there was no prospect of his contributing from his earnings and no suggestion of other assets being discovered, it was not to the advantage of creditors, where they were to receive a dividend of 10 cents in the Rand.

¹¹⁹ Working Paper 29, Project 63: *Review of the Law of Insolvency: Prerequisites for and Alternatives to Sequestration* (1989) Schedule 3.

¹²⁰ *Ex Parte Matthyssen* 2003 2 SA 308 (T).

¹²¹ 1957 3 SA 591 (D).

¹²² 1999 4 SA 835 (E).

¹²³ 2001 2 ALL SA 364 (O).

¹²⁴ 2004 4 SA 89 (W) 102 D-G.

This amount has since been changed to a dividend of no less than twenty cents in the Rand with reference to the rule of practice in the North Gauteng High Court, Pretoria, before a sequestration application would be to the advantage of the creditors, following the decision of our courts in *Ex Parte Ogunlaja*.¹²⁵

Meskin¹²⁶ presents the following view:

“It is respectfully submitted that the correct position is that the relevant reason to believe [that there is a benefit for creditors] exists where, after making allowance for the anticipated costs of sequestration, there is a reasonable prospect of an actual payment being made to each creditor who proves a claim, however small such payment may be, unless some other means of dealing with the debtor’s predicament is likely to yield a larger such payment.”

Roestoff and Coetzee¹²⁷ submit that the sequestration process is an expensive one to follow and that it should only be resorted to if it is cost effective to do so. They submit further that the advantage for creditors requirement fulfills an important function in this regard and the solution to the situation where the overburdened debtor is unable to prove advantage for creditors should in their view rather be found in an alternative measure at restructuring the income of the debtor.¹²⁸

It may be that the courts will not declare an estate insolvent, unless the applicant can show that there are enough assets to pay the costs of winding up the estate.¹²⁹ At present a person can thus be too poor to go bankrupt in South Africa.¹³⁰ Rochelle¹³¹ feels that the barrier of “advantage for creditors” serves no purpose in South African insolvency law and should be discarded all together.

¹²⁵ 2011 JOL 27029 (GNP).

¹²⁶ Meskin 2-20.

¹²⁷ Roestoff and Coetzee 2012 *SA Merc LJ* 59.

¹²⁸ *Ibid*.

¹²⁹ Rochelle 1996 *TSAR* 319.

¹³⁰ *Ibid*. See also <http://www.daniepotgieterattorneys.co.za/services/sequestration/faq/> (accessed on 18 July 2012) where in practice, insolvency practitioners experience great frustration with the benefit for creditors requirement because a client can literally be too poor to sequestrate if they cannot come up with the twenty cents in the Rand required by our courts in order to grant a voluntary surrender application.

¹³¹ Rochelle 1996 *TSAR* 319.

It is very distressing to not be able to help a client who is in a dire financial situation and in vital need of debt relief due to the fact that they cannot come up with the advantage for creditors and therefore are unable to apply for voluntary surrender.

3.5 Collective body of creditors

Once a sequestration order is made a *concursum creditorum* comes into being.¹³² The concept of the *concursum creditorum* means that the rights of the creditors as a group are preferred to the rights of the individual creditor.¹³³ In *Walker v Syfret*¹³⁴ the court stated that once the *concursum creditorum* has been established, no transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body of creditors.

Therefore when it is being determined whether or not there is in fact an advantage for creditors, during the sequestration process, it must be assessed not only with reference to one or some of the creditors, but with reference to the effect of the sequestration on the general body of creditors as a whole.¹³⁵ The courts have held that the requirement is fulfilled where it is established that there is an advantage to a “substantial proportion” or “the majority” of the creditors reckoned by value.¹³⁶

In *Trust Wholesalers and Woolens (Pty) Ltd v Mackan*¹³⁷ the court held the advantage as being the advantage of a 'substantial proportion' of the creditors. Selke J expressed the substantial proportion of the total of the debtor's creditors, whether reckoned by number or value, as follows:

“(B)ut it seems to me that it is to be remarked that the subsection does not speak - as did the corresponding provision of Act 32 of 1916 - of "the advantage of the creditors", but of "the advantage of creditors", which suggests that this particular requirement of the subsection is satisfied if there is reason to believe that a substantial proportion of the

¹³² Mars 2.

¹³³ *Ibid.*

¹³⁴ 1911 AD 141.

¹³⁵ Meskin 2-19.

¹³⁶ *Trust Wholesalers and Woolens (Pty) Ltd v Mackan* 1954 2 SA 109 (N); *Fesi v ABSA Bank Ltd* 2000 1 SA 499 (C).

¹³⁷ 1954 2 SA 109 (N).

total of the debtor's creditors, whether reckoned by number or value, will derive advantage from a sequestration.”

However, since the decision in *Woolens*¹³⁸ the Afrikaans text of the Act has dropped the article ‘die’ and the court in *Fesi v ABSA Bank Ltd*¹³⁹ held 'advantage of creditors' meant advantage to the general body of creditors reckoned by value, not number. Thus the respondent (to whom 96% of the total debt of the estate was owed) represented the general body of the creditors. Lusu AJ held further since it was generally accepted that a benefit to the majority of creditors would also be a benefit to the minority and that creditors would know best what was to their advantage, the fact that the respondent was opposed to the application meant that the acceptance of the surrender would not be to the advantage of the creditors.

The concept of advantage for creditors is a relative one and should be judged in relation to the circumstances of each case.¹⁴⁰ In determining advantage for creditors the court must have regard to any other method of regulating the debtor's affairs such as an administration order or debt counselling.¹⁴¹

Where execution is cheaper and more expeditious than sequestration and the sole creditor already has a judgment, generally there is no reason to believe that sequestration will be to the advantage of creditors.¹⁴² However, where the applicant has no judgment, the circumstances may show that the machinery of the Insolvency Act is quicker and cheaper than to issue summons and proceed to judgment and execution where the debtor is hopelessly insolvent and will not be able to meet the judgment.¹⁴³ In this case sequestration may be more advantageous to creditors than the trial process.¹⁴⁴

¹³⁸ *Ibid.*

¹³⁹ 2000 1 SA 499 (C).

¹⁴⁰ Meskin 2-20.

¹⁴¹ *Ibid.* See also *Gardee v Dhanmanta Holdings* 1978 1 SA 1066 (N); *ABSA Bank Ltd v De Klerk* 1999 4 SA 835 (EC).

¹⁴² Meskin 2-20.

¹⁴³ *Ibid.* See also *ABSA Bank Ltd v De Klerk* 1999 4 SA 835 (EC).

¹⁴⁴ Meskin 2-20.

3.6 Abuse of the sequestration process

3.6.1 Friendly sequestration

The courts have an inherent jurisdiction to prevent the abuse of its processes.¹⁴⁵ Therefore the court must carefully scrutinize every application to ensure that there are not hidden ulterior motives for the sequestration application before it. This is so because the sequestration procedure can eventually afford the debtor a discharge of all his pre-sequestration debts. Therefore the courts must satisfy themselves that the application does in fact ensure an advantage to creditors and to prevent any prejudice to them.¹⁴⁶

The so-called “friendly sequestration” has been said by many to be an abuse of the process.¹⁴⁷ This is so because it is said that the debtor and creditor are colluding together to avoid the stringent requirements of advantage for creditors by applying for a compulsory sequestration instead of the debtor simply applying for voluntary surrender himself. However, the mere fact that an application before the court is a “friendly” one, is not *per se* an abuse of the process.¹⁴⁸ It would, however, be an abuse of the system where, on the facts, the court would be unable to grant a sequestration order, or where it could do so, there is no genuine intention in the parties to achieve a sequestration for its own sake.¹⁴⁹

The practice of “friendly” sequestrations is not unknown in South African law and collusion in such an environment has long been deprecated by our courts.¹⁵⁰ Our courts have over the past fifteen years taken a firm stance with regard to the granting of friendly sequestrations, making it clear that the court has a duty to scrutinize the application with great care to ensure advantage for creditors.¹⁵¹ In *Esterhuizen v*

¹⁴⁵ Meskin 2-23.

¹⁴⁶ Roestoff and Coetzee 2012 *SA Merc LJ* 56.

¹⁴⁷ Evans “Friendly sequestrations, the abuse of the process of court, and possible solutions for overburdened debtors” 2001 *SA Merc LJ* 485.

¹⁴⁸ *Esterhuizen v Swanepoel* 2004 (4) SA 89 (W).

¹⁴⁹ An example would be where the intention is to enable the debtor to avoid contending with creditors’ proceedings to enforce his liabilities to them and ultimately, through the machinery of the Insolvency Act, to shed such liabilities. *Epstein v Epstein* 1987 4 SA 606 (C); *Esterhuizen v Swanepoel* 2004 (4) SA 89 (W); *Brinkman v Botha* 2004 JOL 13093 (C).

¹⁵⁰ *Ex parte Shmukler-Tshiko* 2013 JOL 29999 (GSJ).

¹⁵¹ Roestoff and Coetzee 2012 *SA Merc LJ* 56.

*Swanepoel*¹⁵² the court cautioned that co-operation may tend towards collusion and that the courts should be “scrupulous in ensuring that the assistance does not amount to abuse.”

In *Brinkman v Botha*¹⁵³ the court refused to confirm a provisional sequestration order on the basis that the facts indicated that there was collusion between the applicant and the respondent to assist the latter to evade payment to his ex-wife of the amount due to her under a divorce settlement agreement. The court also found that the conduct of the applicant’s attorney amounted to an abuse of the process of court and ordered that the costs of the application be borne by the applicant and his attorney jointly and severally.

In *Ex parte Arntzen*¹⁵⁴ Gorven J summarised his view on friendly sequestrations as follows:

“Reference was made to the number of matters where a final order was granted and ‘the friendly creditor makes no effort to have a trustee appointed or to prove his claim, no creditor takes steps to prove a claim because of a fear of contribution, the debtor waits for the dust to settle and with his old creditors off his back carries on business as normal’. In situations such as this the sequestration of the debtor's estate cannot be said to have been to the advantage of creditors. Such applications constitute an abuse of the process of court and undermine the rights and interests of creditors. The only person who benefits is the debtor, often at the expense of creditors.”

3.6.2 Incorrect information

Another abuse of the system is where the applicant does not give sufficient or accurate information as to the assets of the debtor and their proper valuations. The court must make a decision based on the information presented to it by the applicant that there are sufficient assets in the estate to cover the costs of sequestration and

¹⁵² 2004 4 SA 89 (W) 102 D–G.

¹⁵³ 2004 JOL 13093 (C).

¹⁵⁴ 2013 1 SA 49(KZP).

pay a not negligible dividend to the creditors.¹⁵⁵ In the case of voluntary surrender the applicant debtor must lodge a statement of affairs in duplicate at the Master's office.¹⁵⁶ This statement of affairs is a statement of the debtor's financial position and other matters, and should be prepared shortly before lodging the application. The object of this statement is to inform the creditors of the debtor's financial position and must therefore be drafted with great attention to detail. If the statement is carelessly drafted or misleading or incorrect, the court may refuse to accept the surrender.¹⁵⁷

The court in *Ex parte Arntzen*¹⁵⁸ held that the courts have long required an applicant in voluntary surrender applications to make a full and frank disclosure. Gorven J went on to say the following:

"The required high level of disclosure is also affected, in no small measure, by the fact that the application is ordinarily brought on an ex parte basis, as is the present one. There is ample authority that applications brought on that basis require the utmost good faith. The principles were succinctly stated by Le Roux J in *Schlesinger v Schlesinger*¹⁵⁹ in a rescission application as follows:

- (1) in ex parte applications all material facts must be disclosed which might influence a Court in coming to a decision;
- (2) the non-disclosure or suppression of facts need not be wilful or mala fide to incur the penalty of rescission; and
- (3) the Court, apprised of the true facts, has a discretion to set aside the formal order or to preserve it."

Mars¹⁶⁰ explains this strict approach by our courts as follows:

The requirement that all information presented to the court in an application for surrender must be accurate and that valuations must be exact, arises from the courts' insistence that a debtor who is pressed by his creditors does not over-estimate the value of his estate in order to obtain relief from his financial burdens. The administration of estates

¹⁵⁵ See *London Estates v Nair* 1957 3 SA 591 (W); *ABSA Bank Ltd v De Klerk* 1999 4 SA 835 (EC); *Ex parte Mattysen* 2003 2 SA 308 (T); *Ex parte Kelly* 2008 4 SA 615 (T); *Ex parte Shmukler-Tshiko* 2013 JOL 29999 (GSJ); *Ex parte Arntzen* 2013 1 SA 49 (KZP).

¹⁵⁶ Section 4(3).

¹⁵⁷ Mars 59. Mars opines that the surrender must be rejected if the court is not convinced that a full and frank disclosure of all the debtor's affairs has been made.

¹⁵⁸ 2013 1 SA 49(KZP).

¹⁵⁹ 1979 4 SA 342 (W).

¹⁶⁰ Mars 63.

has over the years developed into a very lucrative and therefore competitive profession. The pressure has therefore increased to identify debtors whose sequestration or liquidation may render a lucrative return to lawyers, trustees, liquidators, valuers and auctioneers. Advertisements in the media canvassing debtors who are desirous of ridding themselves of their financial burdens have become commonplace. This has increased the risks for debtors and creditors alike. Debtors, who might be able to meet their obligations if they were given the opportunity to properly arrange their affairs, are pressurized into opting for insolvency proceedings instead. On the other hand, insolvency practitioners are tempted to present a rosy picture of the debtor's affairs that bears little semblance to reality, resulting in an estate being declared insolvent that renders little or no dividend for creditors once the fees of the various participants in voluntary surrender proceedings have been deducted and the administration costs have been paid.

These abuses of the judicial system have led to the courts insisting even more stringently on exact information regarding the debtor's affairs being presented to them and to demand a realistic calculation of the potential dividend.¹⁶¹ A further reason for requiring a higher level of disclosure, in voluntary surrender applications, is that an outright order can be given on the first appearance in court whereas, in most sequestration applications, a provisional order precedes a final order in a two-stage process.¹⁶²

In *Ex Parte Matthyssen*¹⁶³ the court held that the valuator had no personal knowledge of the relevant facts. She had prepared her reports using information given to her by another unspecified source. Her valuations were said to be bald statements, which were not supported by any facts. The court said that it had to make a decision on the evidence whether there were enough assets to pay the costs of the sequestration and to pay a not negligible dividend to the creditors. Without an acceptable basis for calculating the dividend, the court could not conclude that the surrender would be to the advantage of the creditors and the application was refused.

¹⁶¹ *Ibid.*

¹⁶² *Ex parte Arntzen* 2013 1 SA 49(KZP).

¹⁶³ 2003 2 SA 308 (T).

In *Ex Parte Kelly*¹⁶⁴ the attorney alleged a certain amount for costs in the application and then billed seven times that amount after the sequestration order was granted. If the court had allowed this amount of the bill of costs, concurrent creditors would have received no dividend and would have been liable to make a contribution. The court held that the dividend to be paid to the creditors is calculated on the strength of that allegation and that the court grants the application in belief that those figures are correct and that a dividend will be paid. The court accordingly held that the application should be understood to contain an undertaking by the attorney to limit his fees to those he has stated in the application.

In *Ex Parte Bouwer*¹⁶⁵ the court held that it needs sufficient information to grant an order. The court is not just a rubber stamp and it has a discretion that must be exercised judicially. In order for the court to do so the applicant must be candid, especially because it is an *ex parte* application. Where applicants in previous cases failed to disclose the detailed reasons for their insolvency, their movable assets as well as their income and expenditure, the court ruled that the applications should be dismissed as no advantage for creditors can be established where the information is inadequate.

In *Ex Parte Ogunlanja*¹⁶⁶ the court pointed out that the valuator, who functions as an expert witness, should be completely independent and completely in the dark regarding the amount that the insolvent's assets will have to be disposed of in a forced sale situation in order to guarantee an advantage to creditors. Therefore the court held that valuers should certify under oath that they had prepared the valuation without knowledge of the facts of the relevant application and the applicant and his attorney should likewise confirm that the valuator was not made privy to the value of the assets to be realized in order to constitute an advantage for creditors. The application used similar and same documents from previous cases. The property was overvalued and there was no basis for the calculations and evaluations. The Court also felt uneasy with the close relationship between the

¹⁶⁴ 2008 4 SA 615 (T).

¹⁶⁵ 2009 6 SA 382 (GNP).

¹⁶⁶ 2011 JOL 27029 (GNP).

evaluators and the applicants and dismissed the application as there was no advantage for creditors established by the applicants.

Mars¹⁶⁷ further opines that our insolvency legislation should provide for judicial oversight of the sequestration process:

“There is a gap in our present legislation as there is no provision for judicial oversight of the actual results of the liquidation process. Judges have no insight into the liquidation and distribution process and are never informed whether the dividend that was held up to creditors in the application was in fact realized. Nor do the courts have any insight into the fees and commissions that are paid to the various practitioners involved in the liquidation process and can therefore never assess whether the body of creditors is properly protected by the current system. This is an issue that should be addressed in the new insolvency legislation that is apparently in preparation.”

Roestoff and Coetzee¹⁶⁸ submit that the court, when considering its discretion to grant a sequestration order, should follow a balanced approach taking into consideration the interests regarding the choice of debt relief and that this raises the further question of whether the time has not come for the insolvency legislation to specifically require an advantage for the debtor as a prerequisite for compulsory sequestrations. They submit further that in voluntary applications the legislator should specifically provide that the court, when exercising its discretion to grant a sequestration order, should take into consideration the debtor’s interests regarding what the best solution for his debt problems would be.¹⁶⁹

3.7 Proposed law reform

Our insolvency law has been under review for decades now. During 1987 the South African Law Reform Commission commenced an investigation of the law of insolvency in its entirety and a Project Committee was appointed to conduct and direct the review as Project 63. From this committee stemmed several working papers and eventually culminated in the 1996 Draft Insolvency Bill and Explanatory

¹⁶⁷ Mars 64.

¹⁶⁸ Roestoff and Coetzee 2012 *SA Merc LJ* 63.

¹⁶⁹ *Ibid.*

Memorandum being published for comment¹⁷⁰ The Report and Draft Bill that was published by the South African Law Reform Commission during 2000 replaced the Draft Bill of 1996. In 2003 the Cabinet approved the idea of a single Unified Insolvency Act that would apply to the various types of debtors (for example individual natural persons and corporate or juristic persons), but apart from a Working Document from the Department of Justice dated 30 June 2010, at present titled the Draft Insolvency and Business Recovery Bill, a formal Reform Bill has not yet been published.

The Law Reform Commission has always been in favour of the retention of the advantage for creditors requirement and from the 2010 Insolvency Bill it would appear that the Commission has not changed its mind in this regard.¹⁷¹ The Law Reform Commission has proposed that provision be made for the granting of a provisional order in the case of voluntary surrender applications as is the case with compulsory sequestration applications and the reason for this being so that the first meeting of creditors can be held before the return date so that the creditors can in terms of clause 38(6) consider whether the sequestration would be to the advantage of the creditors.¹⁷²

The Law Reform Commission submits¹⁷³ that

“It is accepted that a debtor may become insolvent through no fault of his or her own and that such a debtor should be given the opportunity to make a fresh start. Creditors sometimes contribute towards insolvencies by giving credit to debtors who cannot repay it. A balance must be struck between the rights of creditors and giving a debtor an opportunity to make a fresh start. It is, however, expected from debtors to act honestly and assist in the winding up of their insolvent estates.”

In granting a debtor this opportunity for a fresh start, the Law Reform Commission has proposed that provision be made for a pre-liquidation composition with

¹⁷⁰ South African Reform Law Commission “Review of the law of insolvency: Draft Bill and Explanatory memorandum” Working Paper 66 Project 63 (1996). Hereinafter referred to as the “Draft Insolvency Bill” and “Explanatory Memorandum” respectively.

¹⁷¹ Roestoff and Coetzee 2012 *SA Merc LJ* 59.

¹⁷² *Ibid.*

¹⁷³ Par 4.6 of the Explanatory Memorandum.

creditors.¹⁷⁴ This proposed measure is supposed to afford debt relief to debtors who are unable to show an advantage for creditors and are therefore excluded from the sequestration process.¹⁷⁵

The debtor initiates the process by lodging a signed copy of the composition and a sworn statement with the Magistrate's court of the district where he or she resides or carries on business.¹⁷⁶ This process is supervised by the court and provision is made for an investigation into the affairs of the debtor.¹⁷⁷ No creditor may without the permission of the court institute action or apply for liquidation of the debtor's estate in the time between the determination of a date for a hearing and the conclusion thereof.¹⁷⁸

If the composition is accepted by the majority in number and two-thirds in value of the concurrent creditors who vote on the composition, the court shall certify that the composition is accepted as such and thereafter the composition is binding on all creditors who have been informed of the hearing or appeared at the hearing,¹⁷⁹ but the right of a secured or otherwise preferent creditor shall not be prejudiced by the composition, unless he or she consents to the composition in writing.

A composition is not accepted if a creditor demonstrates to the satisfaction of the magistrate that it accords a benefit to one creditor over another creditor to which he or she would not have been entitled on liquidation of the debtor's estate. Where the composition is not accepted by the required majority of creditors and the debtor is unable to pay substantially more than what is offered in the composition, the court must declare that the proceedings have ceased and that the debtor is in the position that he was in prior to commencement thereof. Alternatively, the court must determine if section 74 of the Magistrates' Courts Act can be applied to the debtor and if so, apply the provisions accordingly and within the discretion of the presiding offices.¹⁸⁰

¹⁷⁴ Schedule 4 of the Explanatory Memorandum.

¹⁷⁵ Roestoff and Coetzee 2012 *SA Merc LJ* 70.

¹⁷⁶ Cl 118(1).

¹⁷⁷ Cl 118(10)(e).

¹⁷⁸ Cl 118(23).

¹⁷⁹ Cl 118(17).

¹⁸⁰ Cl 118(22)(a) and (b). See also Roestoff and Coetzee 2012 *SA Merc LJ* 71.

Roestoff and Coetzee submit that the proposed measure of a pre-liquidation composition as a viable option for a debtor seeking debt relief is fatally flawed in that it would not, in its current format, provide such a debtor with a discharge if the composition is not accepted by the required majority of creditors.

3.8 Conclusion

One can deduce, from the above, that the principle of a benefit for creditors has been the focus point of many discussions, articles and court decisions so it can be said that it is the cornerstone of our insolvency law. There are comprehensive arguments for both its retention¹⁸¹ as well as its removal from our legislation.¹⁸² The Law Reform Commission are in favour of retaining it in our law.¹⁸³ Nevertheless, they also acknowledge the necessity for a procedure to assist the innocent debtor, in the form of the pre-liquidation composition. However, this procedure does not grant the debtor a discharge of his debt. It is respectfully submitted that the introduction of any debt relief mechanism for the innocent debtor should make provision for the discharge of debts once the process is complete.

This benefit for creditors requirement has also led to abuse of the insolvency law through the development of the so called “friendly” sequestration process where the sequestrating creditor and the debtor collude together in order to bypass the stringent requirements of a voluntary surrender application.¹⁸⁴ In practice it seems as though insolvency practitioners are keen to have the requirement removed from our law or at least altered so as to afford the small debtors with exoneration from the requirement and only require larger creditors to comply with it.

I can appreciate that the requirement should be retained so as to afford creditors some return of monies owed to them. It also places responsibility on the debtor to pay at least some percentage to creditors so that he cannot simply accumulate debt and then have it written off when it suites him. It will undoubtedly cripple the

¹⁸¹ Roestoff and Coetzee 2012 *SA Merc LJ* 53.

¹⁸² Rochelle 1996 *TSAR* 315.

¹⁸³ See par 3.7 above.

¹⁸⁴ See par 3.6.1 above.

economy if all debtors were allowed to take up credit with banks and then simply declare themselves insolvent without having to pay back at least a nominal amount such as the twenty cents as currently is required.

CHAPTER 4

INTERNATIONAL LEGISLATION

4.1 Introduction

This chapter examines the insolvency law regimes of the United States of America and England with regard to debt relief measures for debtors. These systems have undergone fundamental developments over the past few decades in order to bring them in line with modern economic constraints. The relaxation of credit controls and the vast increase in the number of insolvent debtors have forced many jurisdictions to reconsider their traditional consumer insolvency philosophies.¹⁸⁵

Traditionally, European jurisdictions have had a very conservative approach towards offering debt relief to debtors and a discharge was never an element of the solution. However, the United States accepted a more sympathetic attitude towards the debtor with their “fresh start” philosophy.¹⁸⁶ Now, at the beginning of the 21st century, the profile of international consumer insolvency has changed significantly. Many of the conservative “creditor friendly” jurisdictions have since progressed towards a more liberal consumer bankruptcy system and the United States has reversed its liberal “fresh start” attitude and adopted a more conservative stance in its philosophy since the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005.¹⁸⁷

I will attempt to explore the possibility of transplanting some of the international developments into our South African insolvency model, taking into consideration the trials and tribulations experienced by America and England in developing their insolvency regimes. There seem to be many lessons that can be learned from these first world countries, both positive and negative. These experiences and knowledge could be fundamental in affording a smooth transition when new developments are

¹⁸⁵ Calitz “Developments in the United States’ consumer bankruptcy law: A South African perspective” 2007 *Obiter* 397.

¹⁸⁶ Calitz 2007 *Obiter* 398.

¹⁸⁷ *Ibid.*

introduced into South African insolvency legislation as proposed by the South African Law Reform Commission.¹⁸⁸

4.2 United States of America

In the United States, the rules and procedures relating to filing for bankruptcy are governed by federal law under the Bankruptcy Reform Act of 1978.¹⁸⁹ The aims of the American insolvency system are twofold: Rehabilitation of the overburdened debtor and the equal treatment of creditors.¹⁹⁰ The so called “fresh start policy” has been an essential principle of American bankruptcy law for many years.¹⁹¹ In *Local Loan Co v Hunt*¹⁹² the court declared as follows:

“One of the primary purposes of the bankruptcy act is to ‘relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes’. This purpose of the act has been again and again emphasized by the courts as being of a public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.”

American bankruptcy is based on an open access system which makes it more affordable to approach the courts. With regards to natural persons the Code provides for two forms of debt relief, namely, liquidation in terms of Chapter 7 and reorganisation under Chapter 13. Each of these options follows a different procedure and is designed to suit a different kind of debtor.¹⁹³ Individuals may also file under Chapter 11, which provides for a similar reorganisation process as in Chapter 13. However, the Chapter 11 procedure is more expensive and therefore generally only

¹⁸⁸ See discussion in par 3.7 above.

¹⁸⁹ Hereinafter referred to as the “Code”.

¹⁹⁰ Jackson and Scott “On the nature of bankruptcy: An essay on bankruptcy sharing and the creditor’s bargain” 1989 *Virginia Law Review* 155.

¹⁹¹ Boraine and Roestoff “Developments in American consumer bankruptcy law: Lessons for South Africa” (Part 1 and 2) 2000 *Obiter* 34.

¹⁹² 292 US 234 244 (1934).

¹⁹³ Calitz 2007 *Obiter* 401.

used by businesses.¹⁹⁴ Bankruptcy cases are commenced by the filing of a petition which may be done voluntarily or involuntarily and insolvency or an inability to pay debts need not be alleged.¹⁹⁵

4.2.1 Chapter 7 liquidations

Chapter 7 intends an orderly court-supervised procedure whereby a trustee is appointed to see to the collection and realization of the debtor's assets and the consequent distribution to creditors.¹⁹⁶ The distribution is made subject to the debtor's right to retain certain exempt property and the rights of secured creditors.¹⁹⁷ Consumers, who successfully file for Chapter 7 debt relief and meet certain requirements, receive an immediate discharge of most of their unsecured debts which also shields any post-petition income and new assets acquired.¹⁹⁸ The discharge, however, only solves the debtor's problems with respect to unsecured claims. With regard to secured creditors, a debtor must decide whether to try and pay them, sign reaffirmation agreements¹⁹⁹ or surrender the secured property.²⁰⁰ If all the debtor's assets are exempt or subject to valid liens, the trustee will normally file a "no asset" report with the court, and there will be no distribution to unsecured creditors. Most Chapter 7 cases involving individual debtors are no asset cases.²⁰¹ Filing a petition under Chapter 7 automatically stays most collection actions against

¹⁹⁴ For purposes of this discussion I will focus on the individual debtor and therefore Chapter 11 bankruptcies will not be discussed.

¹⁹⁵ Boraine and Roestoff 2000 *Obiter* 47.

¹⁹⁶ 11 U.S.C. Sections 101(41), 109(b), 701 and 704.

¹⁹⁷ Among the schedules that an individual debtor will file is a schedule of "exempt" property. The Bankruptcy Code allows an individual debtor to protect some property from the claims of creditors because it is exempt under federal bankruptcy law or under the laws of the debtor's home state. 11 U.S.C. section 522(b). Many states have taken advantage of a provision in the Bankruptcy Code that permits each state to adopt its own exemption law in place of the federal exemptions. In other jurisdictions, the individual debtor has the option of choosing between a federal package of exemptions or the exemptions available under state law. Thus, whether certain property is exempt and may be kept by the debtor is often a question of state law.

¹⁹⁸ 11 U.S.C. section 727.

¹⁹⁹ Reaffirmation entails a promise by the debtor to pay a debt despite its discharge. It is generally believed that reaffirmations are only appropriate when a debtor is behind in payments of secured debt and does not wish to pursue Chapter 13 proceedings. Acceptance of the offer of reaffirmation enables the debtor to keep the encumbered property and pay the debt over time. If the debtor decides to reaffirm a debt, he or she must do so before the discharge is entered – see Boraine and Roestoff 2000 *Obiter* 49.

²⁰⁰ Boraine and Roestoff 2000 *Obiter* 51.

²⁰¹ See <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx> accessed 15 August 2013.

the debtor or the debtor's property.²⁰² The stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even telephone calls demanding payments.²⁰³ The individual debtor's primary concerns in a Chapter 7 case are to retain exempt property and to receive a discharge that covers as many debts as possible. The biggest disadvantage of a Chapter 7 filing is the fact that the debtor will lose all non-exempt assets.²⁰⁴

4.2.2 Chapter 13 reorganisations

Chapter 13 enables individuals with regular income to develop a plan to repay all or part of their debts.²⁰⁵ For this reason the Chapter 13 procedure is often referred to as the "wage earner's plan". The maximum duration of a repayment plan is usually not more than three years. However, a court may approve a plan for no longer than five years.²⁰⁶ The proposed plan is approved or disapproved at a confirmation hearing depending on whether it meets the Code's requirements.²⁰⁷ Filing the petition under Chapter 13 automatically stays most collection actions against the debtor or the debtor's property.²⁰⁸ Chapter 13 also contains a special automatic stay provision that protects co-debtors. Unless the bankruptcy court authorizes otherwise, a creditor may not seek to collect a "consumer debt" from any individual who is liable along with the debtor.²⁰⁹

The debtor need not surrender his or her assets as is the case under Chapter 7 liquidations. A Chapter 13 discharge is only granted when the debtor has made full payments in terms of the payment plan.²¹⁰ After confirmation of a plan, circumstances may arise that prevent the debtor from completing the plan. In such

²⁰² 11 U.S.C. Section 362. But filing the petition does not stay certain types of actions listed under 11 U.S.C. Section 362(b), and the stay may be effective only for a short time in some situations.

²⁰³ See <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx> accessed 15 August 2013.

²⁰⁴ Boraie and Roestoff 2000 *Obiter* 51.

²⁰⁵ 11 U.S.C. Section 1321.

²⁰⁶ 11 U.S.C. Section 1322(d).

²⁰⁷ 11 U.S.C. Sections 1324 and 1325.

²⁰⁸ 11 U.S.C. Section 362.

²⁰⁹ 11 U.S.C. Section 1301(a).

²¹⁰ 11 U.S.C. Section 1328(a).

situations, the debtor may ask the court to grant a "hardship discharge."²¹¹ The discharge in a Chapter 13 case is somewhat broader than in a Chapter 7 case. Chapter 13 is often preferable to a Chapter 7 application as it enables the debtor to retain valuable assets and pay creditors out of post-petition income, as opposed to the Chapter 7 procedure which represents the liquidation of the debtor's assets.²¹²

4.2.3 American bankruptcy reform

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was signed into law in 2005 and represents the largest overhaul of the Bankruptcy Code since its enactment in 1978. The reform provisions are mostly creditor orientated with an attempt to tighten abuse and fraud regulation within the bankruptcy system.²¹³ The most significant amendments introduced by the new legislation are the means testing provision and the introduction of a mandatory financial management programme.²¹⁴

A debtor can no longer choose between filing a Chapter 7 or 13 petition and must first comply with a means test in order to qualify for a Chapter 7 filing. The means test is applied to determine whether a debtor's net current monthly income exceeds their state's median income.²¹⁵ The new legislation also changed a debtor's obligation to repay in Chapter 13 and instead of proposing his or her own repayment plan, the new means test determines the debtor's disposable income and requires that he or she use all of it for five years to repay the creditors.²¹⁶

²¹¹ 11 U.S.C. Section 1328(b). Generally, such a discharge is available only if: (1) the debtor's failure to complete plan payments is due to circumstances beyond the debtor's control and through no fault of the debtor; (2) creditors have received at least as much as they would have received in a chapter 7 liquidation case; and (3) modification of the plan is not possible.

²¹² 11 U.S.C. Sections 307, 308, 322. See also Calitz 2007 *Obiter* 402.

²¹³ 11 U.S.C. Section 101. See also Calitz 2007 *Obiter* 405.

²¹⁴ Calitz 2007 *Obiter* 405.

²¹⁵ Under the means test, a debtor at the low end of the income range would remain eligible for Chapter 7 relief if the amount of his or her income net of expenses is less than \$100 per month (\$6,000 over five years). At the high end, a debtor would not be eligible for Chapter 7 relief if his or her net income is equal to or more than \$166.67 per month (\$10,000 over five years). In the middle are debtors whose net monthly income is \$100 - \$166.67 (\$6,000 - \$999,999 over five years). If income less expenses multiplied by 60 is between \$6,000 and \$10,000 conversion or dismissal is only required if the debtor has sufficient income to pay 25 percent of non-priority unsecured claims.

²¹⁶ Calitz 2007 *Obiter* 405.

The BAPCPA also makes provision for mandatory credit counselling and post-petition financial management education.²¹⁷ Subject to a few exceptions a debtor may not initiate bankruptcy proceedings under any Chapter unless he or she, during the 180-day period ending on the date of filing of the petition, received from an approved non-profit budget and credit counselling agency an individual or group briefing²¹⁸ that outlined the opportunities for available credit counselling and assisted the debtor in performing a related budget analysis.²¹⁹ In order to receive a discharge under either Chapter 7 or 13 a debtor must complete an instructional course concerning personal financial management described in section 111.²²⁰

The reform of the American system has moved away from an open-access pro-debtor bankruptcy regime with the liberal “fresh start” approach as one of its pillars.²²¹ This reform was necessary in order to achieve improved equality of rights between the debtors and creditors. Unlike the South African system which requires advantage for creditors, the Code does not base the right to a discharge on a certain level of payment to creditors.²²² Instead, the new legislation looks at the debtor’s earning capacity and provides mandatory education with regards to personal financial management. Although the American bankruptcy system has seen a shift in favour of creditors, the “fresh start” principle is still at its core, in that the debtor receives a discharge of debts under both Chapter 7 and 13 proceedings. It is respectfully submitted that the mandatory financial management education is an ingenious development and could be a valuable inclusion in South Africa’s insolvency law reform.

²¹⁷ 11 U.S.C. Sections 727(a)(11) and 1328(g).

²¹⁸ Including a briefing conducted by telephone or on the Internet.

²¹⁹ 11 U.S.C. Section 109(h)(1).

²²⁰ 11 U.S.C. Sections 727(a)(11) and 1328(g). The Code provides limited exceptions to the “financial management” requirement if the US trustee or bankruptcy administrator determines (1) that there are inadequate educational programmes available or (2) if the debtor is disabled or incapacitated or on active military duty in a combat zone.

²²¹ Calitz 2007 *Obiter* 407.

²²² Roestoff and Coetzee “A critical evaluation of consumer debt relief in South Africa – Lessons from the United States of America, England and Wales and suggestions for the way forward” 2012 *SA Merc LJ* 73.

4.3 England

The insolvency system of England, governing both individual as well as juristic insolvencies, is codified in one unified law and the Insolvency Act 1986 is the main source of insolvency law in Britain. The English system has several alternatives to bankruptcy and can be described as pro-debtor due to various provisions in the Act. The Insolvency Act was amended by the Enterprise Act of 2002 and it seems that one of the main aims of this Act is to reduce the stigma attached to bankruptcy and to afford the bankrupt a fresh start once he is discharged.²²³

A petition for a bankruptcy order may be brought voluntarily by the debtor himself or one of the debtor's creditors²²⁴ if it can be proven that the debtor is unable to pay his debts.²²⁵ Once the order is granted, the estate vests in the official receiver²²⁶ who is later appointed as trustee or until another trustee is appointed.²²⁷ The function of the trustee is to get in, realise and distribute the debtor's estate using his own discretion in accordance with prescribed rules.²²⁸ The debtor receives an automatic discharge from bankruptcy and all its restrictions at the end of the period of one year beginning with the date on which the bankruptcy commences.²²⁹ However, where a criminal bankruptcy order has been made against the debtor, the debtor must apply to court to receive such a discharge no sooner than five years after the date of bankruptcy.²³⁰ Unlike the South African system which requires advantage for creditors, the Insolvency Act 1986 is similar to the American template, in that it too does not base the right to a discharge on a certain level of payment to creditors. Calitz²³¹ submits that during the almost three decade attempt to adopt new insolvency legislation, South Africa has become isolated and has ignored global trends with regard to developments in international consumer insolvency law.

²²³ Roestoff and Renke "Debt relief for consumers – The interaction between insolvency and consumer protection legislation" (part 2) 2006 *Obiter* 106.

²²⁴ Section 264(1)(a) and (b).

²²⁵ Sections 267(2)(c) and 272(1).

²²⁶ Section 287.

²²⁷ Sections 292(1)(a), (b) and (c). The estate vests in the trustee immediately upon his appointment – Section 306(1).

²²⁸ Section 305(2).

²²⁹ Section 279(1). If before the end of that period the official receiver files with the court a notice stating that investigation of the conduct and affairs of the bankrupt under section 289 is unnecessary or concluded, the bankrupt is discharged when the notice is filed – Section 279(2).

²³⁰ Section 208(1) read with sections 279(6) and 264(1)(d).

²³¹ Calitz 2007 *Obiter* 399.

4.3.1 NINA debtors

“NINA” is an acronym for “No Income or No Assets” and the Insolvency Act 1986 now allows for these debtors to apply for a so-called debt relief order.²³² This amendment was inserted into the Insolvency Act 1986 through the Tribunals, Courts and Enforcement Act 2007. A debtor who is unable to pay his or her debts may apply to the official receiver, through an approved intermediary, for such an order²³³ and it is intended to operate with no court involvement unless an interested party decides to intervene on one of the grounds mentioned in section 251G.

In order to qualify for a debt relief order, a debtor’s total debt must not be more than £15,000,²³⁴ total assets must not be more than £300 and his or her disposable income, after deducting all normal living expenses, must not be more than £50 per month.²³⁵ A debt relief order lasts for one year²³⁶ and a debtor is only allowed to apply for a debt relief order once every six years.²³⁷ While the debt relief order is in effect, creditors named on the order cannot take any action to recover their money without permission from the court.²³⁸ At the end of the one year period, if the debtor’s circumstances have not changed, they will receive a discharge from the debts that were included in their order.²³⁹

Creditors interests are also taken into consideration and they may object to the making of the order or to the inclusion of a debt on the list of qualifying debt within 30 days after the creditor in question has been notified of the making of the order.²⁴⁰ While the order is in force the debtor is subject to similar restrictions as in

²³² Part 7A and sections 251A–251X.

²³³ Sections 251A(1) and B(1).

²³⁴ This does not include unliquidated or debts that cannot be included in a debt relief order.

²³⁵ See <http://www.bis.gov.uk/insolvency/personal-insolvency/dro-debtors#1> accessed 18 September 2013.

²³⁶ Section 251H.

²³⁷ See Sch 4ZA(5).

²³⁸ Section 251G.

²³⁹ Section 251I.

²⁴⁰ Section 251K(1) and (2). See also <http://www.bis.gov.uk/insolvency/personal-insolvency/dro-debtors#1> accessed 18 September 2013.

bankruptcy.²⁴¹ Should it be found that the debtor was dishonest before or during the period of the debt relief order, the official receiver would be able to apply for a debt relief restriction order which will extend the period of restriction for up to 15 years.²⁴² If there is a change in the debtor's circumstances, the debtor must notify the official receiver as soon as reasonably practicable if (a) there is an increase in his income during the moratorium period applicable to the order; (b) he acquires any property or any property is devolved upon him during that period; (c) he becomes aware of any error in or omission from any information supplied by him to the official receiver after the determination date.²⁴³

4.4 Conclusion

American bankruptcy law has offered debtors a virtually painless path to becoming debt free since 1898, and limiting whether a debtor can elect to proceed via either chapter 7 or 13 proceedings is indeed a radical departure from the American bankruptcy history.²⁴⁴ The American system is seen as the leading model for insolvency laws worldwide and it contains no comparing provision to that of a “benefit for creditors” as does the South African dispensation.

The English law has undergone several changes over the past few decades with the latest being the addition of the debt relief orders for the so-called NINA debtors.²⁴⁵ The English model too does not make provision for a benefit for creditors or that a certain amount must be paid to creditors before the debtor receives a discharge.

I submit that the benefit for creditors requirement is a huge obstacle to be crossed before a debtor can approach the court with an application for the surrender of his estate. The American regime is based on an open access principle and the benefit for creditors requirement in South African insolvency law is the proverbial “ball and

²⁴¹ Section 251S. The debtor may, for example, not obtain credit over £500 without disclosing to the creditor that he or she is subject to a debt relief order.

²⁴² Sch 4ZB.

²⁴³ 251J(5)(a), (b) and (c).

²⁴⁴ See par 4.2.3 above.

²⁴⁵ See par 4.3.1 above.

chain” limiting access to our courts for overburdened debtors in desperate need of debt relief.

Rochelle²⁴⁶ submits the following:

“Were the penalties for financial failure lowered from their current levels in South Africa, citizens and companies would take more economic risks to succeed. More businesses would start, more jobs would be created and society as a whole would benefit. Those who fail would not become modern lepers, but instead would receive another chance to be productive for themselves and society. This model has worked well for the United States in this century; in South Africa, rapid economic expansion can be assisted by adopting the American approach. Society should not reward the cautious man who buries his talent and takes no chances; it most emphatically should do everything in its power to assist the man who creates jobs – the man who strives to turn his one talent into ten – even if he fails in the attempt.”

²⁴⁶ Rochelle 1996 *TSAR* 315.

CHAPTER 5

CONCLUSION

It is evident from the research done in this dissertation that the benefit for creditors requirement in the Insolvency Act is the point of departure when the courts consider the granting of a sequestration order.²⁴⁷ This requirement has been a stumbling block for almost a century and it seems as though it will be a stumbling block for the century to come if one considers the South African Law Reform Commission's report to retain this requirement.²⁴⁸ From the discussion above, one can also conclude that the Insolvency Act is very much creditor orientated and only offers debt relief as a consequence of the discharge of all pre-sequestration debts after rehabilitation.

The court will grant the order in voluntary surrender applications if it is satisfied that the requirements prescribed in section six are complied with. With regard to compulsory sequestration, it will grant a final order of sequestration on the return date if it is satisfied that the requirements prescribed by section twelve have been proved.²⁴⁹ It is clear as stated by case law that the Insolvency Act was drafted for the benefit of creditors and not for the relief of harassed debtors.²⁵⁰ The advantage for creditors requirement is prescribed for both voluntary surrender as well as compulsory sequestration and is a stumbling block to obtain debt relief.

The sequestration process provides debt relief to individual debtors, because following the sequestration order the debtor may be rehabilitated.²⁵¹ Rehabilitation has the effect of discharging all pre-sequestration debt and further relieving the debtor of every disability resulting from sequestration. Sequestration is an expensive procedure to follow and because of the dilemma of debtors not being able to prove advantage for creditors, sequestration would in many cases not provide an outcome to debtors seeking debt relief.

²⁴⁷ See discussion of case law in ch 3 above.

²⁴⁸ See par 3.7 above.

²⁴⁹ See ch 3 above.

²⁵⁰ *Ibid.*

²⁵¹ Section 129.

Notwithstanding the worldwide trend to accommodate overburdened debtors seeking debt relief, the South African insolvency system has remained largely creditor orientated.²⁵² It is submitted that the Act was drafted in a time when consumer credit was fairly scarce in comparison today and the time has come for a complete overhaul of South Africa's current debt relief procedures. There has been a drastic change in the South African economic and social environmental circumstances and I think that it is time for the legislator to reassess some of the deep-rooted principles in the South African insolvency law.

However challenging it may seem, some thought must be given to make the insolvency system in South Africa more debtor friendly. In order to do this we can turn to legislation of other countries.²⁵³

The underlying philosophy of the American model is that the debtor is a victim to unforeseen circumstances and should promptly be allowed back into society without the millstone of perpetual indebtedness.²⁵⁴ South Africa cannot remain untouched by developments in Europe and America, and the signs are there that that in South African insolvency law, too, more emphasis is gradually being placed on the plight of the insolvent debtor and the opportunity to be given a fresh start.²⁵⁵ A lesson South Africa can inter alia learn from the American experience is that any law reform effort, which involves a change in approach and philosophy, will be accompanied by a healthy level of criticism and cynicism.²⁵⁶

While it has become an international trend to characterize the US as the model for consumer insolvency reform and develop more debtor friendly insolvency systems, it is ironic that with the enactment of the BAPCPA the US has reversed its liberal "fresh start" attitude and adopted a stance considerably more conservative in its philosophy as was the case previously.²⁵⁷ This goes to show that a delicate balance must be achieved between the interests of both debtors and creditors and that a complete

²⁵² Roestoff and Coetzee "A critical evaluation of consumer debt relief in South Africa – Lessons from the United States of America, England and Wales and suggestions for the way forward" 2012 *SA Merc LJ* 75.

²⁵³ See ch 4 above.

²⁵⁴ Calitz 2007 *Obiter* 400.

²⁵⁵ Loubser 1997 *SA Merc LJ* 326.

²⁵⁶ Calitz 2007 *Obiter* 415.

²⁵⁷ Calitz 2007 *Obiter* 399. See also par 4.2.3 above.

debtor orientated system is also not the answer. I support the view of Roestoff and Coetzee²⁵⁸ that three procedures should be provided for, namely, an assets liquidation procedure and an income restructuring procedure, as provided by the American model, and lastly, by following the example of England and Wales, a procedure affording relief to debtors with no income and no assets.

Financial education in South Africa also represents a huge challenge for its insolvency regime. South Africa boasts an emerging economy that includes a legacy of previously disadvantaged consumers with modest exposure to a free market economy.²⁵⁹ Therefore it is submitted that the completion of an instructional course concerning personal financial management, as proposed by the BAPCPA, should be welcome in any South African reform of its insolvency law.²⁶⁰

I can appreciate that the requirement of benefit for creditors should be retained so as to afford creditors some return of monies owed to them. However, the procedure must make provision for a debtor who has become insolvent due to no fault of his own. He should be given the opportunity to surrender his estate and be granted debt relief so that he can rehabilitate himself and once again become a contributing member to society. The creditor must accept that he too has added to the lack of advantage for creditors in extending credit to a debtor who does not have adequate security and must therefore also accept some responsibility for the debtor's affairs.

Therefore I submit that a system should be developed where any debtor can apply for sequestration. Once sequestrated, the trustee who is appointed must investigate the estate to see whether the debtor's financial situation is due to his own fault or as a result of contributory reckless lending from creditors. If it is found that the debtor is innocent he should be allowed to receive a discharge regardless of whether there is any benefit to creditors or not. However, if it is found by the trustee that the debtor has become insolvent due to his own fault or fraudulent activities, then that debtor must have a benefit for creditors and pay off a certain percentage of the credit before he may be allowed to rehabilitate.

²⁵⁸ Roestoff and Coetzee 2012 *SA Merc LJ* 75.

²⁵⁹ Calitz 2007 *Obiter* 416.

²⁶⁰ See par 4.2.3 above.

It is respectfully submitted that the South African insolvency model is too creditor orientated and archaic in its approach to offering debt relief to overburdened debtors when compared with other jurisdictions.²⁶¹ However, a significant paradigm shift is needed, away from the stigma that goes along with insolvency before amendments should be introduced into our law. Our law has evolved painfully slow since 1936. It is submitted that in the current world economic climate with increased consumer credit availability a complete overhaul of our law is needed so as to afford the overburdened debtor the opportunity to get back on his feet as soon as possible after insolvency. The long established creditor orientated approach by our courts when exercising their discretion to grant a sequestration order should be brought to an end and any reform of the South African insolvency system should specifically require the court to take into consideration the debtor's interests when exercising its discretion. In the end, South African insolvency law reform should seek to find a balance between debtors' and creditors' interests. This dissertation does not attempt to provide a simple recipe for insolvency reform in South Africa, but rather suggests that the legislator and role players take a step backwards and reconsider some of our insolvency law principles, which seem to be cast in stone.²⁶²

In conclusion it is submitted that the American and English insolvency law has no such parallel provision and both have thriving economies with some of the strongest currencies in the world. I suggest that any reform of the South African insolvency model should do away with this requirement entirely and instead offer the debtor a chance to get back on his feet as soon as possible after insolvency so that he or she can once again become a contributing member of society and the world economy.

²⁶¹ See ch 4 above.

²⁶² *Ibid.*

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